

National Highways Sector Project (Additional Financing) - 2015

The audit of the financial statements of the National Highways Sector Project (Additional Financing) for the year ended 31 December 2015 was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 2.09 of Article II of the Loan Agreement No. 2767 SRI dated 14 December 2011 entered into between the Democratic Socialist Republic of Sri Lanka (GOSL) and the Asian Development Bank (ADB).

1.2 Implementation, Objectives, Funding and Duration of the Project

According to the Loan Agreement, then Ministry of Highways and Investment Promotion, presently the Ministry of Higher Education and Highways is the Executing Agency and the Road Development Authority is the Implementing Agency of the Project. The objective of the Project is to improve the national transport efficiency by upgrading, rehabilitation and realignment of about 60 kilometres of National Highways. As per the Loan Agreement, the estimated total cost of the Project was US\$ 105.60 million equivalent to Rs.13,728 million and out of that US\$ 85 million equivalent to Rs.11,050 million was agreed to be provided by the Asian Development Bank. The Project commenced its activities on 14 December 2011 and scheduled to be completed by 31 December 2015. However, the closing date of the Loan had been extended up to 31 December 2016.

1.3 Responsibility of the Management for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.4 Auditor's Responsibility

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with Sri Lanka Auditing Standards. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Project's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the management as well as evaluating the overall presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion. The examination also included such tests as deemed necessary to assess the following.

- (a) Whether the systems and controls were adequate from the point of view of internal control so as to ensure a satisfactory control over Project management and the reliability of books, records, etc. relating to the operations of the Project.
- (b) Whether the expenditure shown in the financial statements of the Project had been satisfactorily reconciled with the enhanced financial reports and progress reports maintained by the Project.
- (c) Whether adequate accounting records were maintained on a continuing basis to show the expenditure of the Project from the funds of the Government of Sri Lanka and the Lending Agency, the progress of the Project in financial and physical terms, the assets and liabilities arising from the operations of the Project, the identifications of the purchases made out of the Loan, etc.
- (d) Whether the withdrawals under the Loan had been made in accordance with the specifications laid down in the Loan Agreement.
- (e) Whether the funds, materials and equipments supplied under the Loan had been utilized for the purposes of the Project.
- (f) Whether the expenditure had been correctly identified according to the classification adopted for the implementation of the Project.
- (g) Whether the financial statements had been prepared on the basis of Sri Lanka Public Sector Accounting Standards.
- (h) Whether satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (i) Whether the financial covenants laid down in the Loan Agreement had been complied with.

1.5 Basis for Qualified Audit Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2. Financial Statements

2.1 Opinion

So far as appears from my examination and to the best of information and according to the explanations given to me, except for the effects of the adjustments arising from the matters referred to in paragraph 2.2 of this report, I am of opinion that,

- (a) the Project had maintained proper accounting records for the year ended 31 December 2015 and the financial statements give a true and fair view of the state of affairs of the Project as at 31 December 2015 in accordance with Sri Lanka Public Sector Accounting Standards,

- (b) the funds provided had been utilized for the purposes for which they were provided,
- (c) the opening and closing balance, withdrawals from and replenishments to the Special (Dollar) Accounts had been truly and fairly disclosed in the books and records maintained by the Project and the balances as at 31 December 2015 had been satisfactorily reconciled with the accounting records of the Central Bank of Sri Lanka (CBSL) as at that date,
- (d) the Statements of Expenditure (SOEs) submitted could be fairly relied upon to support the applications for reimbursement in accordance with the requirements specified in the Loan Agreement,
- (e) the satisfactory measures had been taken by the management to rectify the issues highlighted in my previous year audit report, and
- (f) the financial covenants laid down in the Loan Agreement had been complied with.

2.2 Comments on Financial Statements

2.2.1 Accounting Deficiencies

The following accounting deficiencies are observed in audit.

- (a) The operating costs aggregating Rs. 31 million incurred for all 03 foreign funded projects which remained under the purview of the Project Monitoring Unit had been treated as the cost of this Project instead of being charged proportionately to the respective projects.
- (b) Rehabilitation and improvement works of the road from Hikkaduwa to Southern Expressway certified at a cost of Rs 213.22 million had not been brought to account as at 31 December 2015. As a result, the value of civil-works in progress and the liabilities at the end of the year under review had been understated by respective amounts.

2.2.2 Lack of Documentary Evidence for audit

Although the annual verification had been carried out at the end of the year under review, reports on verification of assets valued at Rs.1.59 million had not been made available for audit.

2.2.3 Non - Compliance with Laws, Rules and Regulations

The reimbursement of medical expenses amounting to Rs.1.40 million for the staff members of the Road Development Authority attached to the Project and the overhead expenses amounting to Rs. 2.61 million had been remitted to the Road Development Authority, contrary to the

Section 8.3.9 and 8.6 of the Circular No. PED/12 dated 02 June 2003 issued by the Department of Public Enterprises of the General Treasury.

3. Financial and Performance

3.1 Utilization of Funds

Certain significant statistics relating to the financing of funds, budgetary provision for the year under review and the utilization of funds during the year under review and up to 31 December 2015 are shown below.

Source	Amount agreed for financing in the Loan Agreement		Allocation made in the Budget Estimate for the year under review	<u>Funds utilized</u>			
	US\$ million	Rs. million		US\$ million	Rs. million	US\$ million	Rs. million
ADB	85.00	11,050	3,126	17.24	2,334	68.62	8,996
GOSL	20.60	2,678	1,480	10.14	1,478	32.80	4,665
	<u>105.60</u>	<u>13,728</u>	<u>4,606</u>	<u>27.38</u>	<u>3,812</u>	<u>101.42</u>	<u>13,661</u>

According to the above information, US\$ 68.62 million equivalent to Rs. 8,996 million representing 80 per cent of the allocation of US\$ 85 million equivalent to Rs 11,050 million under the Loan had been utilized as at 31 December 2015.

3.2 Physical Progress

According to the information received, the improvements works of the several sections of 05 national roads of 44.83 kilometres had been completed by the Project as at 31 December 2015. Further, the improvement works of the several sections of Pamankada- Kesbewa Road and Nugegoda -Homagama Road introduced in July 2015, as additional works of the Project had not been completed at the end of the period of the Project.

3.3 Contract Administration

The following observations are made.

- As a regular feature the scope of the several road improvement works included in the original designs had been changed by the Project subsequently. Therefore, 214 items included in the original Bill of Quantities valued at Rs.161.73 million representing 29.09 per cent of contract value of the improvement works of Matara - Godagama Road had been cancelled and 15 new items valued at Rs 116.57 million representing

20.5 per cent of the cost of contract had been introduced. Further, the scope of improvement works of the road from Aluthgama to Southern Expressway was also changed by cancelling of 326 items in the Bill of Quantities valued at Rs. 737.64 million allowing undue financial benefits to the contractor on additional amount of mobilization advances made thereon.

- (b) It was observed that the contractor engaged in the rehabilitation works of the roads from Aluthgama to Southern Expressway and Hikkaduwa to Southern Expressway had been granted extensions of time for a period of 90 days each, without considering the failures of the contractor such as improper work plans and shortages of labour force deployed etc., as revealed at the meeting of Steering Committee held on 07 May 2015. Further, the additional costs of Rs.22.51 million and Rs.26.80 million on preliminary works and the price fluctuation of Rs 20.33 million and Rs 8.53 million had been incurred respectively for the above mentioned roads. In addition, the delay charges of Rs 38.93 million had been waived off by the Project.
- (c) The improvement works of Katukuranda to Nagoda Road had been completed with delays in 90 days due to failures of the Project to hand over the sites to the contractor on time. As a result, price fluctuation of Rs 15.19 million and delay charges of Rs.17.31 million had to be paid to the contractor.
- (d) It was observed that a sum of Rs.74.82 million had been spent by the Project on shifting of pipe lines and other infrastructure development works to be carried out by the National Water Supply and Drainage Board and Local Authorities on improvement works of the road from Hikkaduwa to Southern Expressway which were not included in the scope of the works.
- (e) It was observed that the adequate action on quality assurance on improvement works of the Nugegoda- Homagama Road had not been taken, due to following reasons.
 - (i) The Quality Management Assurance System Plan required to be submitted within 28 days of the commencement of the contract, as per Clause No.4.9 of the condition of contract on improvement works had not been prepared and submitted by the contractor. Further, the check lists to ensure the adherence of quality standards under 12 activities had also not been maintained as the Quality Assurance Inspectors were not deployed by the contractor.
 - (ii) The strength of precast concrete cover slab and interlock paving blocks laid on improvement works under a variation order had not been verified to ensure crushing strength thereon, even though a sum of Rs. 6.27 million and Rs. 1.45 million paid thereon respectively to the contractor.
 - (iii) According to the testing results for the months of April, September, October and November 2015 on the thickness of Asphalt Concrete Binder Course laid from at 1+000 kilometre to 15 + 360 kilometre was remained from 104.6 mm to 122 mm, even though the maximum required range of thickness was remained from 35 mm to 75 mm. Further, according to the testing reports, the thickness of Asphalt Concrete

Wearing Course laid on the above mentioned sections of the road was remained from 91.7 mm to 108 mm, eventhough the maximum thickness thereon ranging from 45 mm to 55 mm required to be maintained.

3.4 Extraneous Activities

According to the information received, the Project had not taken timely action to obtain the exemption on payment of Value Added Taxes. As a result, the Value Added Taxes amounting to Rs 27.34 million on improvement works Pamankada - Kesbewa Road had been paid by the Project to the contractors, out of the contribution of the Government of Sri Lanka.

3.5 Land Acquisition Activities

It was observed that the compensation aggregating Rs.2,582 million had been paid up to 31 December 2015 on land acquisitions and resettlement purposes of improvement works of 05 roads, eventhough the total allocation of Rs.1,343 million only made thereon for the year under review. It was observed that the financial controls on payment of compensation on land acquisition was not adequate, as details of the crown land and private lands to be acquired, payments made on the approval of Land and Resettlement Committee and details of advance payments made on land acquisition purposes etc, were not available at the Project Monitoring Unit.